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The Macroeconomics of Nebraska's Competitiveness World Agricultural Markets

Frank Zahn
University of Nebraska at Omaha

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Nebraska faces a cyclical and a secular decline in its competitiveness in world agricultural markets. Economic instability and technological advances account for much of the decline, along with unfair trade practices and counterproductive government intervention. The short-term forecasts for the U.S. economy are fairly bright, but the farm economy, particularly in Nebraska, is gloomy. Because it is unlikely that government price and income supports will continue at current levels, Nebraska must take some bold steps to provide a healthier farm sector. Policy choices for state action include supporting federal policies that promote domestic and international economic stability, fair international trade, and the elimination of farm income supplements based on production; funding for research to determine Nebraska's areas of comparative advantage in farm products; implementing programs that expedite reallocation of resources to their most productive uses; and developing a state marketing strategy for each traded product that improves Nebraska's share in world markets.

Until a little over a decade ago, Nebraska's farmers thought they were insulated from the forces that shape the overall or macroeconomy. In the 1970s, it became clear that they were not insulated, and the connections, at first, seemed to be all for the good. Large quantities of Nebraska's farm products were being sold abroad, and farm incomes soared.

Now, the euphoria has passed and the boom of the 1970s is viewed as a short-lived cyclical upturn, rather than a sustainable acceleration in the growth of the farm economy. The upturn was followed by a cyclical downturn in the 1980s. The cyclical downturn, along with an underlying long-term or secular decline in the demand for Nebraska's farm exports, has created serious problems for farmers. Nebraskans recognized more clearly than ever before that the state's farm sector, which is a significant component of the country's farm sector, is quite sensitive to changes in the overall or

macroeconomic environment. As a result, the influence of U.S. macroeconomic policy must be carefully considered when analyzing the problems facing Nebraska's farmers.

Farming in Nebraska is linked to the U.S. farm sector, the U.S. macroeconomy, and the world economy. Growth in international trade since World War II and the emergence of well-developed international credit markets means that farming in Nebraska, along with the whole U.S. economy, is an integral part of the world economy. Moreover, now that the value of the U.S. dollar is allowed to fluctuate in international currency markets, Nebraska's farmers are exposed more than ever to the uncertainties of changes in international economic conditions.

The current worldwide glut of farm products has a negative effect on all U.S. farm exports. Nebraska's economy is influenced more than other states because it is more dependent on export markets. Part of the glut is due to the expansion of farm production during the 1970s. Much of the glut, however, is due to long-term or secular forces, particularly technological advances in agriculture. Both cyclical and secular factors have increased dramatically the quantity and quality of competitors that Nebraska's farmers must face in world markets.

In this chapter, the macroeconomic forces that allow Nebraska's farmers to compete in world markets are discussed, and an assessment of their future prospects is presented. First, the scope and meaning of competitiveness in world markets is discussed. Then, the principal way by which U.S. macroeconomic policy influences the competitiveness of farmers on the supply and demand sides of world agricultural markets is explained. Next, the role of U.S. macroeconomic policy in the cyclical instability of the 1970s and 1980s is

assessed. The factors that influenced the secular decline in competitiveness and the outlook for the U.S. economy into the 1990s are discussed also. Finally, several important guidelines for economic policy and policy initiatives that can help improve the competitiveness of Nebraska's farmers in world markets are discussed.

Competitiveness in World Markets

Conventional wisdom tells us that a country can benefit from making the products that it can produce more cheaply than other countries and trading them for products that other countries can produce more cheaply. Stated differently, if each country does what it does better than other countries and trades for what others do better, each country gets what it wants at the lowest unit cost possible. This is the principle of comparative advantage.

Trade based on the principle of comparative advantage provides the most output of goods and services possible for each country, given its scarce supplies of labor, capital, and other resources. Natural resources, large domestic markets (which make it possible to realize economies of scale), human capital resources, and technological advances (the most important factor) have aided comparative advantage in the United States.

Although technological advances may provide a country with comparative advantage for awhile, other countries soon learn to use the technology and the country loses its comparative advantage. Classic examples include Britain's loss of comparative advantage in textile production to Japan, the United States, and Western Europe during the 19th century. And, these countries are now losing comparative advantage to countries in Asia and Africa where labor is cheaper and more abundant.

The United States has gained and lost comparative advantage in one product after another, including automobiles, textiles, steel, heavy electrical generating equipment, and transistors. Despite losses, the United States remains in the forefront of world trade. One reason for this is that the United States continues to adapt to changes in world trade conditions. Today, the United States is gaining in international trade of jet aircraft, computers, and other recently developed products. Although comparative advantage, once lost, can be reclaimed by reducing unit costs, in a dynamic world, countries (as well as states or regions within countries) may lose comparative advantage permanently.

U.S. farmers probably still have a comparative advantage in some agricultural products (corn, wheat, and soybeans). U.S. exports of agricultural products jumped sixfold from 1970 ($7.3 billion) to 1981 ($43.3 billion). Nebraska shared in this growth. By 1981, 30 percent of Nebraska's farm output was exported to other states and countries. Moreover, Nebraska's significance in total U.S. farm output expanded relative to other states. In 1981, it ranked fifth among the states in cash sales (U.S. Department of Agriculture, 1985).

However, since 1981, U.S. farm exports have fallen sharply, down 25 percent in 1985 from the peak of 1981, and down another 12 percent in 1986. (These estimates by the U.S. Department of Agriculture (1985) are preliminary.) Nebraska has been one of the hardest hit states. These sharp declines suggest a loss of comparative advantage or that comparative advantage alone does not explain how much farmers are able to sell in world markets.

A country has a competitive advantage, or is competitive, if it can sell its products in world markets. Comparative advantage, or comparatively lower costs of

production, is an important factor influencing a country's competitive advantage. However, other factors influence it as well (Hushak, 1987).

Factors such as market imperfections and macroeconomic policy can override cost considerations in markets, making it possible for a country to enjoy competitive advantage in product markets, that is, making it possible to sell the products it produces, regardless of comparative advantage. Guided by desires, such as self-sufficiency, preservation of the family (small scale) farm, and nationalism, countries formulate and implement policies in an attempt to improve their competitive advantage, even though they do not have a comparative advantage.

Some countries provide government subsidies and price support to keep high-cost producers in business others restrict imports with tariffs and quotas, while others attempt to lower the value of their currency to make their exports more attractive in world markets. In these cases, gains in competitive advantage are generally short lived. Countries respond by formulating policies that minimize the effects of another country's efforts to manipulate competitive advantage, or they retaliate against these unfair trade practices.

Although comparative advantage remains the ideal basis for trade, it is only one factor that must be considered in a comprehensive analysis of the competitive advantage or competitiveness of farmers. Other factors also influence the willingness and ability of farmers to produce and sell their products. Cost or supply side considerations determine a farmer's willingness to produce and offer farm products for sale, while spending or demand side considerations determine a farmer's ability to sell. Both supply side and demand side considerations are important in understanding the

competitiveness of Nebraska's farmers in world agricultural markets.

Macroeconomic Policy

U.S. macroeconomic policy influences the supply and demand sides of agricultural markets and, thereby, the competitiveness of all U.S. farmers, including those in Nebraska (Gardner, 1981). Two basic types of macroeconomic policy exist: Monetary policy and fiscal policy. Monetary policy changes the rate of growth of money available for spending in the economy. It is controlled mainly by the Board of Governors of the Federal Reserve System in Washington, DC. Fiscal policy alters total spending directly by changing the rate of growth of government spending in the economy or indirectly by changing the rate of growth of after-tax income available to consumers and businesses. It is controlled mainly by the U.S. Congress and the President. The primary domestic objective of these policies is to maintain total spending in the economy, which ensures full employment without adding to inflation.

Even with the best of intentions, macroeconomic policies are often inappropriate, and spending grows either too little or too much. When total spending in the economy grows less than the nation's output of goods and services, inventories pile up, the inflation rate falls, and the economy experiences recession. Also, less spending reduces the demand for credit and nominal interest rates (those quoted in financial markets) fall. But, when total spending grows more than the nation's output of goods and services, the inflation rate rises and the economy recovers. At close to full employment, if the gap between the rates of growth of total spending and total output widens, the economy may experience a rising

inflation rate and negligible growth in output of goods and services. Additional spending also increases the demand for credit, and nominal interest rates rise.

Because macroeconomic policies influence nominal interest rates and the inflation rate, they also affect the difference between them, namely real (inflation-adjusted) interest rates:

Real Interest Rates = Nominal Interest Rates - The Inflation Rate

Table 1 shows the influences of U.S. monetary and fiscal policies on the inflation rate, nominal interest rates, and real interest rates. To finance an increase in spending or a decrease in taxes, the federal government must borrow money in financial markets. This increased demand for credit places upward pressure on nominal interest rates. When the federal government spends what it borrows or when taxpayers spend their additional after-tax income on goods and services, upward pressure is placed on the inflation rate. Higher nominal interest rates raise real interest rates, while a higher inflation rate reduces real interest rates. The influences tend to

Table 1 - Direction of impact of U.S. macroeconomic policies on interest rates and inflation

Item	Fiscal policy	Monetary policy
Nominal interest rates	↑	↓
Minus		
Inflation rate	↑	↑
Equals		
Real interest rates	↑ (?)	↓

be offsetting and the net effect is ambiguous. It depends on which of the two, the interest rate effect or the inflation rate effect, dominates. Given that the quantity of money in the economy does not change, it is likely that the interest rate effect dominates, and expansionary fiscal policy raises real interest rates. Of course, the effects of contractionary fiscal policy, that is, less government spending or increased taxes, produces the opposite result.

When the Board of Governors of the Federal Reserve System, the nation's monetary authority, increases the quantity of money in the economy, downward pressure is placed on nominal interest rates. More of any asset in the economy generally implies that the price for its use falls. As the new money is spent on goods and services, upward pressure is placed on the inflation rate. Expansionary monetary policy lowers nominal interest rates and raises the inflation rate, and each of these changes reduces real interest rates. Of course, contractionary monetary policy, which reduces the nation's money supply, produces the opposite effect.

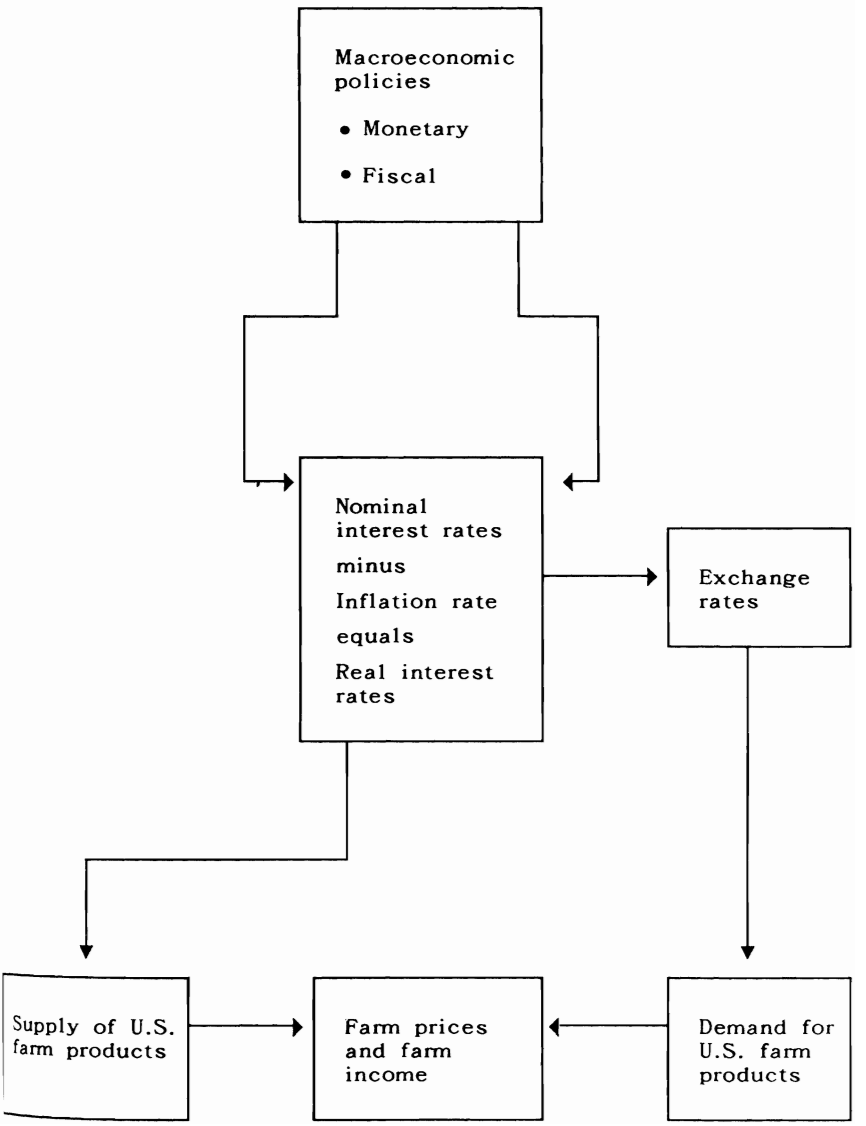
The Link with Interest Rates

Real interest rates transmit changes in macroeconomic policy to the supply and demand sides of the U.S. agricultural markets (figure 1). Real interest rates influence the supply of farm products directly by changing costs of production and the demand for farm products by changing exchange rates. In turn, the supply of and demand for farm products determine farm prices and sales or earned income.

A flexible exchange rate system allows changes in real interest rates to affect the demand for farm products (Hakkio, 1986). When real interest rates in the

Figure 1

An Interest Rate Transmission Mechanism for Macroeconomic Policy



United States change relative to those in other countries, they affect exchange rates and export demand. For example, when real interest rates in the United States increase, U.S. financial assets become relatively more profitable than those of other countries. People in other countries then demand more U.S. dollars to buy more U.S. financial assets. In turn, the increased demand for U.S. dollars raises the value of the dollar relative to other currencies in international currency markets. However, a more expensive dollar reduces foreign demand for U.S. products, including farm products (U.S. exports), and increases domestic demand for foreign products (U.S. imports). Hence, higher real interest rates lead to a higher exchange value for the U.S. dollar, and U.S. farm products become more expensive or less competitive in world markets.

Changes in real interest rates affect the supply of farm products by changing costs of production. An increase in interest rates, for example, raises the cost of credit to finance purchases of new capital; to carry inventories; to finance purchases of inputs, such as feeder livestock, seeds, fuel, and fertilizer; and to service variable-interest debt. Just as higher real interest rates increase the value of the dollar and make U.S. farm products less competitive through the demand side of world markets, they increase production costs and make farm products more expensive or less competitive through the supply side of world markets.

Changes in the supply of and demand for U.S. farm products, brought on by policies that influence real interest rates, alter U.S. farm prices. Moreover, because farm prices are more flexible than other prices, they adjust more quickly to economic change. Consequently, when monetary and fiscal policies either stimulate or reduce total spending in the economy, farm prices change

more quickly than other prices at home and abroad (Frankel, 1984). In free markets, this means that when farm prices rise, farmers produce more than they will be able to sell in world markets when prices again stabilize. Conversely, when prices fall, farmers produce less than they will be able to sell in world markets when prices again stabilize. This overshooting of farm prices lends credibility to the argument that formulation of U.S. macroeconomic policy should take into account the disproportionate effects of policy on the farm sector in the short-term.

Cyclical Rise and Decline in Competitiveness

The markets for farm products were relatively stable during the 1950s and the 1960s. U.S. government regulation of credit markets and macroeconomic policy promoted relatively low and stable real interest rates which stabilized costs of production on the supply side of agricultural markets. Moreover, U.S. monetary policy maintained fixed exchange rates on the U.S. dollar so that, along with an income-insensitive domestic demand for farm products, there was stable growth in the demand for farm products. Beyond the underlying stability created by a relatively stable macroeconomic environment, government price supports ensured that prices of farm products would not fall to unreasonable levels in case of unexpected changes in either the demand or supply sides of agricultural markets.

The stability of the 1950s and early 1960s soon gave way to the boom and bust years of the 1970s and 1980s. Clearly, changes in macroeconomic policy during this period had an important influence on real interest rates, which seriously impaired the competitiveness of U.S. producers, including Nebraska farmers, in world

markets. The effect of changes in the mix of monetary and fiscal policies on variables critical to the competitiveness of farmers during the 1970s and 1980s is summarized in table 2.

Beginning in the mid-1960s, total spending in the economy grew relative to the nation's output of goods and services. There was rapid growth in private sector spending, as well as government spending. More and more government spending was directed toward winning the Vietnam War and solving the country's social problems. This growth in spending was supported by the Federal Reserve pumping more money into the economy. The easy fiscal policy, combined with the easy monetary policy in the late 1960s and 1970s showed that when the desire to spend grows relative to the ability to produce the inflation rate rises.

Table 2 - The direction and impact of U.S. macroeconomic policy on real interest rates for several time periods

Item	Early 1970s[1]	Late 1970s to early 1980s[2]	Since 1985[3]
Nominal interest rates	(Small) ↑	(Large) ↑	↓
Minus			
Inflation rate	(Large) ↑	(Large) ↓	↔
Equals			
Real interest rates	↓	↑	↓
Exchange rates[4]	↓	↑	↓

[1]This period was characterized by easy fiscal policies and easy monetary policies.

[2]This period was characterized by easy fiscal policies and tight monetary policies.

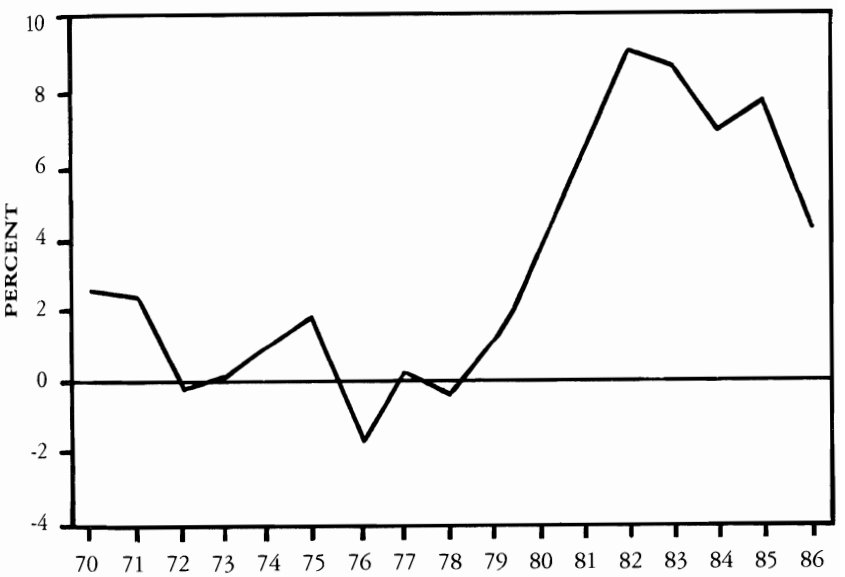
[3]This period was characterized by tighter fiscal policies and easier monetary policies.

[4]Foreign currency price of U.S. dollars.

Other factors also helped to increase prices of farm products. In the early 1970s, several short crops overseas drove down world stocks of farm products. Moreover, income growth in developing (Third World) countries increased the demand for food. These factors dramatically increased U.S. farm export demand, and prices of farm products soared.

In the 1970s, nominal interest rates did not adjust sufficiently to offset the rising inflation rate. As a result, real interest rates fell (figure 2). With low and even negative actual real interest rates in the United States, the demand for higher yielding foreign assets increased. The shift from U.S. dollars to other currencies put downward pressure on the exchange value of the dollar in international currency markets. The

FIGURE 2
Real Prime Interest Rate, United States, 1970-86



Source: Wharton Econometrics data base.

pressure was so substantial that the United States abandoned the fixed exchange rate system and let the dollar float against other currencies. As a result, the value of the dollar declined substantially during the 1970s (figure 3). This action ushered in the flexible exchange rate system which evolved in the mid-1970s. The system was expected to permit internal macroeconomic policy independent of fluctuations in the exchange rate. On the downside, however, flexible exchange rates provided the vehicle whereby U.S. producers, including farmers, were exposed to the uncertainties of changes in world market conditions.

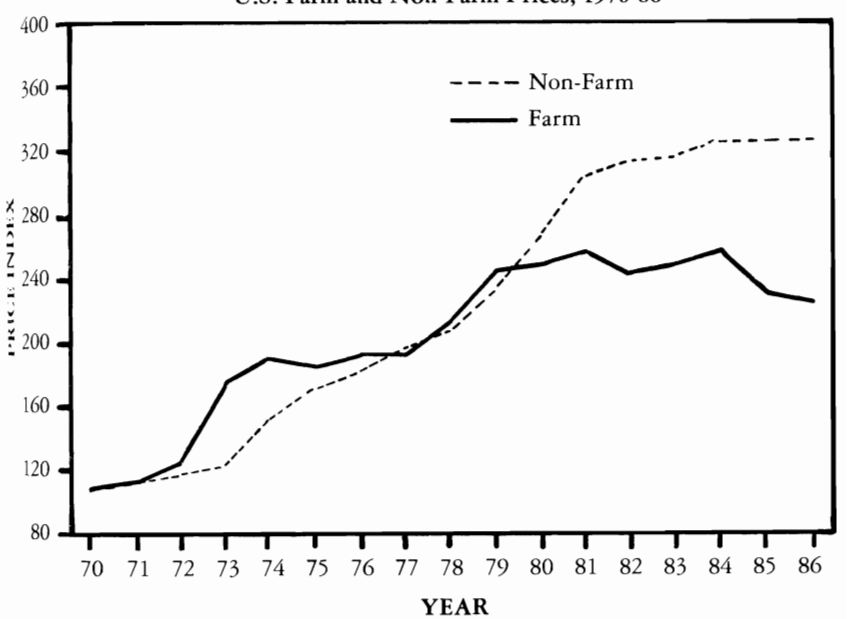
As the value of the dollar fell during the 1970s, the purchasing power of foreign currencies rose and other countries demanded more U.S. products, including Nebraska farm products. Abundant credit, available at

FIGURE 3
Federal Reserve Trade Weighted Exchange Rate
for the U.S. Dollar, 1970-86

Source: Wharton Econometrics data base.

low real interest rates, promoted growth in exports to Third World countries as well. The increase in farm export demand resulted in upward pressure on farm prices, and farmers responded with substantial increases in farm production. In fact, prices of farm products increased relatively more than prices of other products during most of the 1970s, that is, the terms of trade between farmers and other domestic producers in the economy changed in favor of the farmer (figure 4). The increased demand for farm products and the general increase in demand for real assets, which serve as hedges against inflation, increased the demand for farm assets, particularly farmland. Rising farm equity served as collateral for additional credit, which farmers used to finance capital investment and increase production.

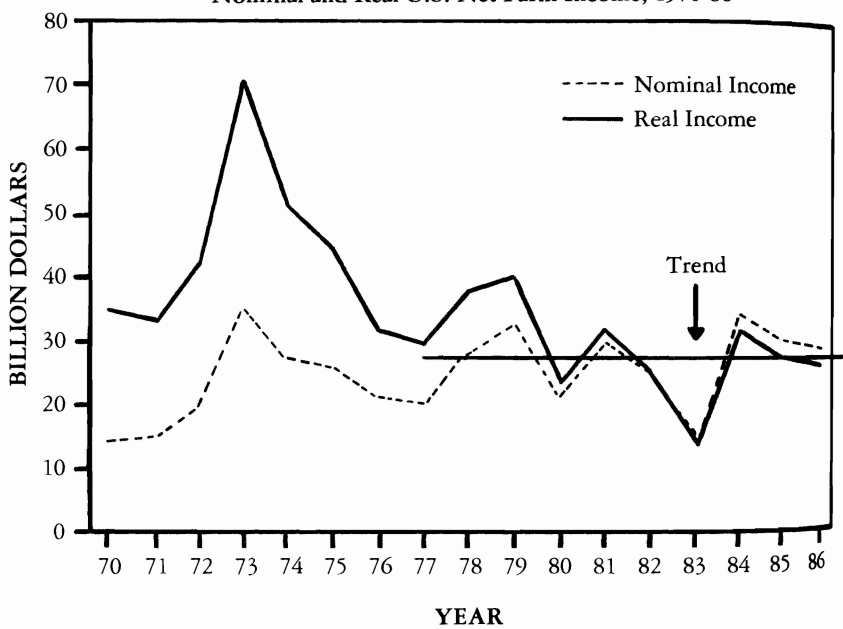
FIGURE 4
U.S. Farm and Non-Farm Prices, 1970-86



Source: Wharton Econometrics data base.

The increased demand for farm products in the early 1970s brought prosperity to the agricultural sector, but prosperity soon gave way to despair for many farmers in the 1980s. Although the trend of nominal net farm income, including government payments, has been relatively flat since the late 1970s (figure 5), its dramatic increase between 1970 and 1973 set off a period of farmland speculation. Rising land prices during the 1970s and rising interest rates during the late 1970s and early 1980s meant that farmers needed more cash to meet their financial obligations. The growth in farm debt, particularly debt on farmland, and the failure of net cash income to grow as it had during the early 1970s strained the ability of some farmers to service their debt and continue operating.

FIGURE 5
Nominal and Real U.S. Net Farm Income, 1970-86



Source: Wharton Econometrics data base.

The prosperity of the 1960s and the early 1970s in the United States was the result of easy fiscal and monetary policies. Substantial growth in total spending relative to total production resulted in double digit inflation. The United States was on a spending spree. "Spend to Prosperity" was one of the slogans of the times.

Although easy fiscal policy continued into the late 1970s, the Federal Reserve initiated a major change in monetary policy to curb inflation. The Federal Reserve brought growth in spending in line with growth in the economy's output by reducing growth in the money supply. As a result, in the early 1980s the inflation rate fell and real interest rates rose (figure 2). In turn, higher real interest rates increased the value of the U.S. dollar (figure 3).

The more expensive U.S. dollar reduced export demand. In addition, rising interest rates increased the debt service payments of Third World countries, the principal growth markets for farm exports. Therefore, export demand declined further. The decline in export demand reduced farm prices, and, once again, farm prices in the 1980s were more responsive than other prices to changes in macroeconomic policy, this time on the downside, that is, the terms of trade turned against the farmer (figure 4).

Farmers lost more than other domestic producers as a result of the correction for inflation. In free markets, prices and quantities supplied would have decreased enough to balance supplies and demands for farm products. However, government price supports prevented much of the adjustment in the 1980s. The result has been overproduction of farm products.

Because of the decline in inflation during the early 1980s, the Federal Reserve has eased monetary policy

since 1985. Monetary ease and tighter fiscal policy, influenced by the spirit, if not the letter, of the Gramm, Rudman, Hollings Bill, have reduced real interest rates (figure 2) and the value of the dollar (figure 3).

The drop in the value of the dollar, measured by the Federal Reserve's general trade weighted index, has increased U.S. export demand. However, a rapid expansion in the export demand for farm products is not expected. A long lag is a contributing factor, but more importantly, currencies of major U.S. competitors in world agricultural markets (for example, Canada, Argentina, and Australia) have depreciated further against the dollar, making these countries more competitive in world markets. In addition, Third World countries, the segment of the world food market with the most potential for growth, remain bogged down with debt repayment problems. So, these countries will not be able to substantially increase purchases of U.S. farm products in the near future. Moreover, long-term or secular forces (discussed in the next section) are working to reduce the growth in U.S. export demand for farm products.

On the supply side of agricultural markets, U.S. farm output continues to increase as farmers continue to respond to government program incentives rather than market signals. Farmers receive government support payment based on their production. The more you produce, the more you get. As a result, overproduction persists.

Ample farm stocks have led to declining farm prices (figure 4) and decreases in net farm income (excluding government payments) in both nominal and real terms. Government payments have continued, however, to maintain the trend in nominal net farm income (including government payments) since the late 1970s (figure 5).

Government payments to farmers accounted for 42 percent of total U.S. net income during 1986. Payments to Nebraska's farmers accounted for about 56 percent of Nebraska's net farm income (U.S. Department of Agriculture, 1985).

Secular Decline in Competitiveness

Growth in productivity implies lower costs of production, which permits gains in competitiveness through gains in comparative advantage. Growth in U.S. agricultural productivity during the 19th century was based on bringing fertile land into production and favorable climatic conditions. These factors are still important, but they account for only part of the spectacular growth in agricultural productivity. While farm output has tripled, labor requirements have fallen by 80 percent and land area in production has changed very little (Nebraska Department of Economic Development, 1987). The principal sources of growth in productivity have been technological advances, education, and capital investment. Biotechnology may ultimately add more to farming productivity than any other development. It has the potential for increasing productivity at rates that are higher than those of the past two centuries (Avery, 1985).

Recently, however, several factors have contributed to a secular or long-term decline in the U.S. farmer's competitiveness in world markets. The most important factor is the worldwide increase in productivity. Shortages of cropland, water erosion, and high oil prices are no longer insurmountable obstacles to countries seeking to develop their farm sectors. The worldwide adoption of technological advances, education, and capital investment increased farm output by 25 percent between

1972 and 1982. In Third World countries, farm output rose 33 percent, compared with 18 percent in developed countries where farm surpluses persist (Hushak, 1987). U.S. farmers now face stiff competition from foreign producers who have made gains in competitive advantage through lower costs of production.

Government subsidies of foreign farm sectors have diminished the U.S. farmer's competitiveness also. For years the United States exported far more than it imported. In the 1970s, the U.S. farm sector was the principal contributor to the U.S. trade surplus. Although about 30 percent of the country's farm output is still sold abroad, the United States had an agricultural trade deficit last year for several months. Foreign producers, particularly countries of the European Economic Community (especially Great Britian and France) gained competitive advantage with farm export subsidies. These subsidies permitted them to become net exporters rather than net importers of grain. This policy reduces the competitiveness of U.S. farmers in world markets and has spawned protectionist trade sentiments in the United States.

Another factor that diminishes the ability of farmers to sell their products is the decline in population growth. Despite the fact that Third World countries, comprising 75 percent of the world's population, have yet to enter the high-demand phase for farm products, the decline in the rates of population growth in the United States and worldwide has reduced the potential growth in demand for food (Nebraska Department of Economic Development, 1987). Both of these rates peaked in the 1960s. Moreover, as incomes increase worldwide, the percentage of income spent on food declines and reduces the growth in demand for farm products.

Still another factor that diminishes the competitiveness of U.S. farmers is the drive for self-sufficiency. Distrust drives importing countries to become self-sufficient, particularly in food production. And, recent actions by the United States have encouraged countries to become self-sufficient, regardless of the comparative advantage. As explained earlier, macroeconomic policy induced instability in the U.S economy during the late 1970s and early 1980s inflated the value of the dollar. The increase was so dramatic that it signaled foreign buyers that U.S. farm products may not always be available at reasonable prices. Rather than be vulnerable to changes in the economic policies of the United States and other exporting countries, importing countries have been encouraged to become self-sufficient in agriculture.

Further, the United States has shown that it will not sell food to countries with whom it disagrees politically. The most recent example is the embargo on grain sales to Russia in 1980. The messages conveyed by this action were that the United States is an unreliable supplier and that political and economic freedom require self-sufficiency.

Finally, protectionist trade policies inhibit growth in farm export demand. When foreigners initiate such policies, U.S. farm products become relatively more expensive, and when the United States initiates such policies, foreigners tend to retaliate with protectionist policies of their own. Protectionism prevents gains in trade and further encourages self-sufficiency.

Because of increased productivity and little growth in world demand, market prices of U.S. farm products may fall so much that many farmers will not be able to continue farming. In fact, this has happened. Overproduction of farm products in the United States,

created by government price supports set above market prices, will persist under current U.S. farm policy. As these supports are reduced, farmers with higher unit costs will have to reduce these costs or go out of business.

In the 1920s, there were 130,000 farms and ranches in Nebraska. Through consolidation, induced by increased productivity, the number is presently 58,000 (U.S. Department of Agriculture, 1985). Genetic engineering and other scientific advantages will continue to increase farm output, and thereby reduce the resources needed to produce farm output. By the year 2000, half of Nebraska's current productive capacity is expected to be superfluous (Nebraska Department of Economic Development, 1987).

Current Outlook for the Macroeconomic Environment

Nebraska's farm sector is strongly influenced by changes in its macroeconomic environment. U.S. macroeconomic policy changes that environment. Therefore, the current stance and direction of U.S. policy is important in addressing Nebraska's farm problems.

The current objective of U.S. macroeconomic policy is expected to continue. Monetary and fiscal policy will be coordinated to promote economic growth while maintaining macroeconomic stability. That is, policy will be used to promote secular or long-term growth while minimizing cyclical activity around the long-term growth path of the economy.

U.S. monetary policy will be used to provide sufficient spending power to accommodate gains in productivity on the supply side of the economy. Monetary restraint will be used to hold down inflation and stabilize nominal interest rates. In the spirit of the Gramm

Rudman-Hollings Bill, fiscal policy will be geared toward reduction of the federal budget deficit, and thereby, help to hold down nominal interest rates.

Farm policy is moving slowly in the direction of reducing price supports of farm products and letting markets again provide accurate signals about what to produce, who should produce it, and how much to produce. Considerable discussion continues in an effort to change the basis for current farm support payments. Basing support on the amount produced encourages overproduction, which is a principal part of the current farm problem.

Although the United States continues to flirt with protectionism, international trade policy is likely to continue to promote free trade, that is, trade based on the comparative advantage criterion. Japan's reluctance to open its markets to U.S. products and the European Economic Community's dumping of government subsidized farm products are major targets of U.S. trade policy. Also, efforts will continue to get other countries to stimulate their growth so they can buy more U.S. exports. In addition, U.S. trade policy will continue to be geared toward international cooperation to stabilize exchange rates. Thus, they will reflect changes in relative growth of productivity (or comparative costs) between countries and not the relative abilities of countries to manipulate exchange rates to their competitive advantage through unfair practices. Hopefully, the 1970s and 1980s have taught us that exchange rate stability is important in developing and maintaining sustained growth in export markets.

Based on current macroeconomic policy, the short-rm outlook for U.S. agriculture is healthier than it has been for some time. Stability is the principal policy objective, with emphasis on short-term stability (to

minimize the severity of cyclical swings) and sustainable secular growth. Given the current direction of macroeconomic policy, government and private forecasts predict that the United States will experience modest, but steady and sustained, growth in output into the 1990s. The Congressional Budget Office expects real gross national product (GNP) to grow between 2.5 and 3.0 percent per year through 1992 (Congressional Budget Office, 1987). The major source of economic growth, other than increases in private sector consumption, is expected to be an increase in net exports (exports less imports). Exports are expected to rise and imports fall. Although unemployment is expected to fall from 7 percent in 1986, to about 6 percent by 1992, real interest rates are expected to fall as nominal rates decline slightly (long-term rates more than short-term rates). The inflation rate is expected to increase from 1.9 percent in 1986, to about 4.3 percent by 1992, and lower real interest rates are expected to reduce further (although not dramatically) the value of the U.S. dollar.

Lower real interest rates will improve supply and demand conditions in agricultural markets for U.S. farmers. But, the overall outlook for U.S farmers, particularly those in Nebraska, is not very bright. Federal government support at current levels is unlikely and, at best, unreliable. Although the debt problem is being solved through repayment, restructuring, and bankruptcy, as stated earlier, Nebraska will probably have to reduce resources in agriculture because of worldwide overproduction.

Policy Choices

Nebraska farmers, like others associated with U.S. agriculture, react mostly to changes in domestic and

international markets. They cannot control these changes, but they can attempt to influence policy initiatives by the federal government. Recent events and the current economic outlook suggest several choices for Nebraska's support of federal government policy.

State Support for Federal Policies

First, Nebraska can support policies that promote fair trade. When trade is fair, competitiveness is determined solely on the basis of comparative advantage. The lower Nebraska's farmers can get their costs through increased productivity, the more competitive they will become. Unfair trade occurs when U.S. or foreign farmers gain a competitive advantage in world markets through means other than decreases in comparative costs (for example, government subsidies, price supports, or favorable macroeconomic policies). These factors distort exchange rates and obscure relative costs of production and exchange between trading partners. Lowering production costs and adopting international trade policies that are designed to neutralize, if not eliminate, unfair trade practices are necessary for sustaining competitiveness in world markets.

Second, Nebraska can support macroeconomic policies that promote and maintain a stable domestic and international environment for production and exchange. Stability reduces the uncertainty associated with various types of production, such as agriculture, in which there are substantial lags between beginning and finishing production and exchange. The boom and bust years of the 1970s and 1980s are a classic example of macroeconomic policy-induced instability. First low, then high, and then low real interest rates and exchange rates contributed to the serious problems of farmers with debt and

overproduction. Policy designed to reduce cyclical instability provides a more certain and less costly environment for farm management.

Third, Nebraska can support efforts of the Federal Reserve Board and the federal government to promote international cooperation for maintaining a stable international environment. Along with exchange rate stability, it is important for U.S. trading partners to stimulate their economies so that they can buy more U.S. farm products. Recently, the United States made some progress in this area. Trading partners have pledged to stimulate their economies if the United States will hold down real interest rates by reducing the federal deficit.

Another issue of concern is the Third World's debt problem. Unfortunately, another casualty of the 1970s and 1980s cycle was the Third World market for U.S. farm products. These countries borrowed heavily to expand their economies and now they use many of their U.S. dollars to service debts rather than to buy U.S. products. Further debt restructuring through international cooperation could substantially improve export demand for U.S. farm products.

Fourth, farm policy must be restructured. Nebraska can support Congress in efforts to phase out farm price supports. Current price supports reduce the competitiveness of U.S. farmers in world markets and encourage overproduction. The heart of the problem with overproduction is that price supports keep relatively high-cost farmers in business. This means that high-cost farmers gain at the expense of their lower cost competitors. Of course, it is the taxpayers and consumers who pay for all this. Government payments may be warranted while phasing out expensive and counterproductive price supports. But, the humanitarian

policy of providing government support for farmers need not encourage overproduction.

In addition to supporting the federal government policies suggested above, Nebraska can take some direct steps to improve its ability to compete.

State Policies to Support Agricultural Competitiveness

First, Nebraska can support and conduct research to evaluate its areas of actual and potential comparative advantage. No adequate study has been conducted to determine the products for which the United States has a comparative advantage. No such study has been undertaken at the state level either. In a world which is becoming increasingly global and market sensitive, more research is essential.

Second, Nebraska can adapt more quickly to larger scale farm production. Increased productivity (which decreases unit costs) through large-scale production is a worldwide reality and no amount of state legislation, such as Nebraska's Initiative 300, is going to help small-scale farmers survive in world markets. Initiative 300 continues to inhibit Nebraska's efforts to regain its competitive edge in world agricultural markets.

Third, identifying the products in which Nebraska's farmers enjoy a comparative advantage and moving to large-scale production is unlikely to justify retaining current resources in farm production. As mentioned earlier, it is expected that Nebraska will have to reduce the amount of land in agriculture by about half during this century. This is expected to help Nebraska catch up with the deagriculturalization of its economy. This process has been occurring nationally, and to a lesser extent in the state, for the past 100 years. Of course, deagriculturalization must be accompanied by efforts to

develop new sources of income. Futhermore, the adjustment from farm to nonfarm employment will require additional policy initiatives at the state level.

Fourth, Nebraska can initiate measures at the state level (and cooperate at the national level) and thus provide a better marketing strategy for its farm products in world markets. Efforts must be made at the commodity level with buyers in specific countries where it is likely that state officials would be more effective negotiators. Clearly, in an increasingly competitive world the ability of Nebraska's farmers to recapture and expand domestic and international markets will depend on how aggressively the markets are pursued. In order to survive, Nebraska's farmers must become more entrepreneurial in the production and marketing of their products.

Conclusions

Nebraska's farm problem is both cyclical and secular. The macroeconomic policy of the 1970s and 1980s caused a cyclical decline in the competitiveness of farmers in world agricultural markets. Since the early 1980s, the United States has pursued a general policy of restoring macroeconomic stability. Recovery from the cyclical downturn in agriculture is not expected to restore sales of farm products to their peak levels of the 1970s and 1980s. Clearly, preoccupation with cyclical activity has obscured the underlying secular problem of the farm sector.

Substantial increases in productivity, due primarily to technological advances and modest growth in demand, mean lower farm prices and the withdrawal of resources from production. However, government price supports and other forms of protectionism have resulted

in the overproduction of farm products. In the absence of trade based on comparative advantage, the world has no way of determining how much food to produce and who should produce it so that resources are not wasted.

Government price supports obscure accurate market information about possible gains in trade for farmers, and taxpayers are often forced to buy with their tax dollars what they refused to buy as consumers. This state of affairs makes no economic sense. The policy choices presented above may contribute to providing a more rational approach to addressing the problems of agriculture.

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